



OFFICE OF INSPECTOR GENERAL

Catalyst for Improving the Environment

Attestation Report

Natural Resources Defense Council Reported Outlays Under EPA Cooperative Agreements CX82546101, CX82675101, and XA83033101

Report No. 2005-4-00120

September 21, 2005

This report contains findings that describe problems the Office of Inspector General (OIG) has identified and corrective actions the OIG recommends. The report represents the opinion of the OIG, and findings in this report do not necessarily represent the final EPA position. Final determinations on matters in this report will be made by EPA managers in accordance with established audit resolution procedures.

Report Contributors:

Keith Reichard
Richard Valliere
Sabrina Barry
Eileen Collins

Abbreviations

CFR	Code of Federal Regulations
DOI	Department of Interior
EPA	Environmental Protection Agency
OIG	Office of Inspector General
OMB	Office of Management and Budget



At a Glance

Catalyst for Improving the Environment

Why We Did This Examination

We conducted this examination to determine whether (1) the reported outlays fairly present, in all material respects, the allowable costs incurred under EPA cooperative agreements CX82546101, CX82675101 and XA83033101; and (2) the recipient was managing its EPA cooperative agreements in accordance with applicable requirements.

Background

EPA awarded three cooperative agreements to the recipient totaling \$3,260,467. Grant CX82546101 was awarded for storm water education, and grants CX82675101 and XA83033101 were market transformation grants awarded to encourage developing and purchasing energy-efficient products. The project period for the storm water education grant was from December 15, 1996, to October 31, 2001. The project periods for the market transformation grants ran consecutively from September 1, 1998, to December 31, 2005.

For further information, contact our Office of Congressional and Public Liaison at (202) 566-2391.

To view the full report, click on the following link:

www.epa.gov/oig/reports/2005/20050921-2005-4-00120.pdf

Natural Resources Defense Council Reported Outlays Under EPA Cooperative Agreements CX82546101, CX82675101, and XA83033101

What We Found

In our opinion, because of the effects of the questioned outlays discussed below, the reported Federal outlays on the *Financial Status Reports/Federal Cash Transaction Reports* do not present fairly, in all material respects, the allowable outlays incurred in accordance with the terms and conditions of the grants and applicable EPA regulations. We questioned \$1,419,548 of reported outlays because the recipient did not maintain the necessary documentation to fully support the reported costs, as required by Federal regulations. Specifically, the recipient did not (1) obtain required Federal approval for indirect and fringe benefit costs, and (2) perform required cost or price reviews to support the reasonableness for contract costs.

What We Recommend

We recommend that EPA (1) obtain sufficient documentation to support the outlays of \$1,419,548 in accordance with EPA regulations or disallow the costs from Federal grant participation, and (2) negotiate fringe benefit and indirect cost rates in accordance with Office of Management and Budget Circular A-122.

The recipient disagrees with the questioned outlays, but plans to submit for negotiation the required fringe benefit and indirect cost rate proposals.



UNITED STATES ENVIRONMENTAL PROTECTION AGENCY
WASHINGTON, D.C. 20460

OFFICE OF
INSPECTOR GENERAL

September 21, 2005

MEMORANDUM

SUBJECT: Natural Resources Defense Council Reported Outlays Under EPA Cooperative Agreements CX82546101, CX82675101, and XA83033101
Report No. 2005-4-00120

FROM: Michael A. Rickey /s/ *Michael A. Rickey*
Director, Assistance Agreement Audits

TO: Richard Kuhlman
Director, Grants Administration Division

This is the final report to express an opinion on the outlays reported through June 30, 2004, by the Natural Resources Defense Council under cooperative agreements CX82546101, CX82675101, and XA83033101. Our opinion does not extend to the recipient's financial statements taken as a whole, nor does it extend to the quality or results of the funded research. In addition, our conclusions are qualified subject to EPA's acceptance of the work upon completion of the grant.

We have questioned over \$1.4 million because the recipient did not have sufficient documentation to support the allocation of these costs to the EPA grant in accordance with the terms and conditions of the grant. The report represents the opinion of the Office of Inspector General (OIG), and the findings contained in this report do not necessarily represent the final EPA position. The OIG has no objection to the release of this report.

On July 22, 2005, we issued a draft report to the recipient for comment. The recipient did not agree with the reported findings. We have included the recipient's response to the draft report in Appendix B (we did not include the recipient's attachments but they are available upon request). The response is also summarized after each finding with our comments.

Action Required

In accordance with EPA Manual 2750, the action official is required to provide this office with a proposed management decision within 120 days of the date of this transmittal memorandum. The proposed management decision must address each finding and recommendation. Where you disagree with a finding or recommendation, please provide alternative actions and support or precedence for your position

If you have questions concerning this report, please contact Keith Reichard, at (312) 886-3045.

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Background

The U.S. Environmental Protection Agency (EPA) awarded three cooperative agreements to the Natural Resources Defense Council (recipient) totaling \$3,260,467. The recipient was formed in 1970, as a Section 501(c) (3) organization (per Internal Revenue Code requirements), and has offices in New York City, Washington, DC, San Francisco, and Los Angeles. The following table provides some basic information about the authorized project periods and funds awarded under each of the three agreements:

Cooperative Agreement	Award Date	EPA Share	Recipient's Share	Total Costs	Project Period
CX82546101	04/25/97	\$ 857,112	\$45,111	\$ 902,223	12/15/96 - 10/31/01
CX82675101	08/24/98	1,204,362	0	1,204,362	09/01/98 - 12/31/01
XA83033101	08/08/02	1,198,993	0	1,198,993	01/01/02 - 12/31/05
Total		\$3,260,467	\$45,111	\$3,305,578	

Cooperative Agreement CX82546101: This agreement was for the recipient to provide educational services about the causes, impacts, and possible solutions to wet weather pollution. The scope of work includes three specific tasks: (1) to gather information on the impact of storm water, particularly on recreational water use, and to disseminate this information; (2) to conduct a survey to determine what information citizens would find helpful, what they already know, what information they lack, and what aspects of storm water are most important to them; and (3) to focus on one area (EPA's Long Island Sound pilot project) and develop ways to more effectively alert the public and local government to the issues surrounding wet weather pollution and what can be done about it. The recipient was required to provide a 5 percent match of \$45,111.

Cooperative Agreement CX82675101: This agreement was for the recipient to analyze, support, and implement projects that encourage the development and purchase of energy-efficient equipment, primarily in the California market.

Cooperative Agreement XA83033101: This agreement was for the recipient to work within the energy-efficiency and manufacturing community towards long-term market transformation of energy efficient technologies and practices.

To assist the reader in obtaining an understanding of the report, key terms are defined below:

Reported Outlays:	Program expenses or disbursements reported by the recipient on the Federal Cash Transactions Reports or the Final Financial Status Reports
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Questioned Outlays:

Outlays that are (1) contrary to a provision of a law, regulation, agreement, or other documents governing the expenditures of funds, or (2) not supported by adequate documentation.

Independent Auditor's Report

We have examined the total outlays reported by the Natural Resources Defense Council (recipient) under the EPA cooperative agreements, as shown below:

Cooperative Agreement	Financial Status Report/Federal Cash Transactions Report			
	Date Submitted	Period Ending	Reported Outlays	Federal Share Of Outlays Reported
CX82546101	01/25/02	10/31/01	\$904,577	\$857,112 *
CX82675101	03/21/02	12/31/01	1,196,740	1,196,740 *
XA83033101	07/14/04	06/30/04	903,280	903,280**
Total			\$3,004,597	\$2,957,132

* Outlays reported on a Financial Status Report

** Outlays reported on a Federal Cash Transaction Report

The recipient certified that the outlays reported on the *Financial Status Reports*, Standard Form 269A, or the *Federal Cash Transactions Reports*, Standard Form 272, were correct and for the purposes set forth in the agreements. The preparation and certification of the claims was the responsibility of the recipient. Our responsibility is to express an opinion on the reported outlays based on our examination.

Our examination was conducted in accordance with the *Government Auditing Standards* issued by the Comptroller General of the United States, and the attestation standards established for the United States by the American Institute of Certified Public Accountants. We examined, on a test basis, evidence supporting the reported outlays, and performed such other procedures as we considered necessary in the circumstances (see Appendix A for details). We believe that our examination provides a reasonable basis for our opinion.

We questioned \$1,419,548 of the \$3,004,597 in reported outlays, because the recipient did not maintain sufficient documentation to support the allocation of these costs to the EPA grants in accordance with the terms and conditions of the grant.

In our opinion, because of the effects of the questioned outlays discussed in the preceding paragraph, the reported Federal outlays on the *Financial Status Reports/Federal Cash Transaction Reports* do not present fairly, in all material respects, the allowable outlays incurred in accordance with the terms and conditions of the grants and applicable EPA regulations. Details of our examination are included in the *Summary Results of Examination* and supporting schedules that follows.

Keith Reichard

Office of Inspector General
U.S. Environmental Protection Agency
April 29, 2005

Summary Results of Examination

We questioned unallowable reported Federal outlays of \$1,419,548 because the recipient did not maintain the necessary documentation to fully support the reported costs, as required by Federal regulations. The recipient did not prepare or submit its indirect cost rate proposals to EPA as required by Office of Management and Budget (OMB) Circular A-122. Also, the recipient procured sole-source consulting services without justification or performing a cost or pricing review. The questioned outlays are summarized below and detailed in the supporting schedules.

Cooperative Agreement	Reported Outlays	Questioned Outlays	Federal Share Questioned	Schedule
CX82546101	\$904,577	\$308,848	\$293,406*	1
CX82675101	1,196,740	769,549	769,549**	2
XA83033101	903,280	356,593	356,593**	3
Total	\$3,004,597	\$1,434,990	\$1,419,548	

* The Federal share questioned was calculated by applying the 95 percent Federal share to the questioned outlays.

** The Federal share was 100 percent of reported outlays.

Schedule 1
Reported Outlays and Results of Examination for
Cooperative Agreement CX82546101

Description	Reported Outlays	Questioned Outlays	Note
Salary	\$194,837	\$0	1
Fringe Benefits	45,413	45,413	2
Travel	21,303	0	
Contractual	393,721	102,705	3
Other	86,220	0	
Indirect Costs	164,834	164,834	4
Subtotal	\$906,328	\$312,952	
Less: Unexplained Adjustment	(1,751)	(1,751)	5
Reported Outlays	\$904,577	\$311,201	
Less: Outlays in Excess Grant Ceiling		(2,353)	6
Total		\$308,848	

Note 1: Refer to our comments on page 15 entitled *Recipient's Personnel Activity Reports Did Not Comply With OMB Circular A-122*.

Note 2: We questioned fringe benefit costs because the recipient did not submit its fringe benefit cost rate proposals for fiscal years 1997 through 2002 to EPA supporting the rates used in the calculation of the reported outlays as required by OMB Circular A-122. The provisions of OMB Circular A-122, Attachment A, subparagraph E.2. states:

(b) A non-profit organization which has not previously established an indirect cost rate with a Federal agency shall submit its initial indirect cost proposal immediately after the organization is advised that an award will be made and, in no event, later than three months after the effective date of the award... (c) Organizations that have previously established indirect cost rates must submit a new indirect cost proposal to the cognizant agency within six months after the close of each fiscal year.

The recipient did not consider fringe benefits to be indirect costs, and thus did not believe that it was required to submit the fringe rates to EPA.

We disagree with the recipient that the fringe benefits were not indirect costs. According to OMB Circular A-122, costs charged to an award must be either direct or allocated indirect costs. The recipient allocated fringe benefits costs to the EPA grant(s) by applying fringe benefit rates¹ to direct labor. Thus, the fringe benefits are allocated indirect costs that must be authorized by negotiated rate agreements. Accordingly, the recipient was required to prepare and submit the fringe benefit rate proposals to EPA in accordance with the requirements of OMB Circular A-122, Attachment A, subparagraph E.2. Since the recipient did not maintain sufficient records to support the outlays for labor and fringe benefits, the reported outlays are unallowable for Federal grant participation.

In addition, in our draft report, we commented that the recipient may have recovered vacation costs twice: once through the salaries claimed under the EPA agreements, and once through the fringe benefit rates. In response to the draft report, the recipient responded that the actual costs for vacations, holiday, and sick leave are treated as direct and not indirect costs, and did not agree that the net accrued vacation expenses represented a duplication of costs. Nevertheless the recipient informed its Independent Auditor that it will eliminate the accrued vacation expense from its actual fringe benefit rate calculations. We agree with eliminating vacation expenses from the fringe benefits.

Note 3: We questioned reported contractual outlays of \$102,705, detailed as follows:

Description	Questioned Outlays	Note
Fringe Benefits	\$28,697	a
Unsupported	74,008	b
Total	\$102,705	

- a. The questioned outlays represent fringe benefits on employee salaries which were reported as contractual services. The recipient reported short-term and part-time employee as contractual because some of these employees did not receive fringe benefits. We have questioned these outlays based on the same rationale discussed in Note 2.
- b. We questioned labor costs of \$74,008 because the recipient could not provide any labor activity reports to support these outlays, as required by OMB Circular A-122, Attachment B, subparagraph 7.m.

Note 4: The indirect costs were questioned because the recipient did not submit its indirect costs rate proposals for fiscal years 1997 through 2002 to EPA to obtain approval for the rates used in the calculation of reported outlays as required by

¹ The fringe benefits rates for all the EPA grants ranged from 18.7 percent to 24.4 percent of total salaries for fiscal years 1996 through 2004.

OMB Circular A-122. The provisions of OMB Circular A-122, Attachment A, subparagraph E.2. states:

(b) A non-profit organization which has not previously established an indirect cost rate with a Federal agency shall submit its initial indirect cost proposal immediately after the organization is advised that an award will be made and, in no event, later than three months after the effective date of the award... (c) Organizations that have previously established indirect cost rates must submit a new indirect cost proposal to the cognizant agency within six months after the close of each fiscal year.

The recipient did not prepare or submit its indirect cost proposal after it made several attempts to receive clarification on EPA's indirect cost policy, in effect at the time. According to the recipient, EPA has stated numerous times, over the years, via telephone, that it no longer gives written confirmations of indirect cost rates as long as the rate calculation is beneath their threshold of 35 percent, then the rate is acceptable. EPA also stated that the recipient can continue to use its rate for proposals and that it does not have to calculate a new one.

EPA's policy in effect at the time was not in compliance with OMB Circular A-122, Attachment A, subparagraph E.2. – Negotiation and Approval of Indirect Cost Rates. EPA's policy has been rescinded.

Note 5: The recipient was unable to explain why it reduced the reported outlays by \$1,751.

Note 6: The recipient incurred and reported outlays of \$2,353 in excess of the cooperative agreement budget. Accordingly, we have offset the questioned outlays by the same amount.

Recommendation 1

We recommend that EPA:

- a. Obtain sufficient documentation to support the questioned outlays of \$308,848 in accordance with EPA regulations or disallow the questioned Federal share of \$293,406 (\$308,848 x 95 percent).
- b. Ensure that the recipient submits its fringe and indirect cost rates proposals for fiscal years 1997 through 2002 as required by OMB Circular A-122, and not allow any fringe benefits or indirect costs until the rates have been negotiated. In negotiating the rates, we recommend that EPA ensure that the recipient removes:

- i. Accrued vacation expenses from the fringe benefit pool.
- ii. Executive compensation from the indirect cost pools and reallocate the costs to the allocation base (see Schedule 3, Note 4 for our discussion on executive compensation).

Schedule 2
Reported Outlays and Results of Examination for
Cooperative Agreement CX82675101

Description	Reported Outlays	Questioned Outlays	Note
Salary	\$375,662	\$0	1
Fringe Benefits	77,422	77,422	2
Travel	43,302	0	
Contractual	476,244	473,995	3
Other	5,978	0	
Indirect Costs	218,132	218,132	2
Total	\$1,196,740	\$769,549	

Note 1: Refer to our comments on page 15 entitled *Recipient's Personnel Activity Reports Did Not Comply With OMB Circular A-122*.

Note 2: We questioned reported outlays for fringe benefits and indirect costs based on the same rationale as discussed in Schedule 1, Notes 2 and 4.

Note 3: We questioned contractual costs of \$473,995 because the recipient did not (1) procure contractual services in accordance with Title 40 Code of Federal Regulations (CFR) 30.43; (2) justify the lack of competition for purchases over \$100,000 as required by Title 40 CFR 30.46, and (3) perform the required cost or price analyses for the procurement of goods and services obtained under the EPA agreements as required by Title 40 CFR 30.45. Title 40 CFR 30.43 provides that all procurement transactions shall be conducted in a manner to provide, to the maximum extent practical, open and free competition. The recipient did not comply with the provisions of Title 40 CFR 30.43 in that it awarded three contracts to Ecos Consulting valued at \$473,995 without competition, and had no justification to support this lack of competition. Each contract award was in excess of \$100,000.

For purchases over \$100,000, Title 40 CFR 30.46 requires that procurement records and files shall include the following at a minimum: basis for contractor selection, justification for lack of competition when competitive bids or offers are not obtained, and basis for award cost or price. In response to this finding, the recipient indicated that Ecos Consulting possessed a unique set of qualifications that no other consulting firms could provide. According to the recipient, Ecos Consulting was to (1) explore the potential for incorporating energy savings from efficient lighting and appliances into various energy rating systems for new and remodeled homes, and (2) help develop a performance based specification for energy efficient screw based compact fluorescent lamps and provide

recommendations for improvements to the existing specifications for pin-based fixtures, (3) identify opportunities for bulk procurement of energy efficient torchieres, and (4) prepare an in depth white paper on energy efficient lighting for utility program implementers and policy makers. However, the recipient did not provide any documentation to demonstrate that no other organization was capable of performing this work. An undocumented belief that an organization possesses unique qualifications does not justify making a noncompetitive award. There may be other organizations unknown to the recipient that were qualified and could have performed the work more efficiently and effectively. At a minimum, the recipient should have advertised for request for proposals to verify or confirm that only one source was available to do the work.

The recipient also did not perform a cost or pricing analysis of Ecos Consulting's procurement as required by Title 40 CFR 30.45. Title 40 CFR 30.45 provides that some form of cost or price analysis shall be made and documented in the procurement files in connection with every procurement action. In response to this finding, the recipient indicated that Ecos Consulting's rates were very competitive with those charged by other energy efficiency consultants.

The recipient's supposition that Ecos Consulting rates were competitive is both flawed and contrary to the requirements for cost or price analysis. The recipient awarded the contract to Ecos Consulting without competition. Thus, our assumption is none of the firms used for the comparison submitted price quotations. Therefore, it was not possible to compare rates. Further, the sole source justification stated that Ecos Consulting had unique qualifications. It would be inconsistent to compare the Ecos Consulting rates to consultants that did not have similar qualifications.

As a result of this lack of competition and evidence of a cost or pricing analysis, there was no assurance that the contract costs paid under the cooperative agreements were fair and reasonable. Therefore, these costs are not allowable under Federal rules.

Recommendation 2

We recommend that EPA obtain sufficient documentation to support the questioned outlays of \$769,549 in accordance with EPA regulations or disallow the costs.

Schedule 3
Reported Outlays and Results of Examination for
Cooperative Agreement XA83033101

Description	Reported Outlays	Questioned Outlays	Note
Salary	\$313,700	\$0	1
Fringe Benefits	68,106	68,106	2
Travel	27,171	0	
Contractual	331,012	131,835	3
Other	6,639	0	
Indirect Costs	156,652	156,652	4
Total	\$903,280	\$356,593	

Note 1: Refer to our comments on page 15 entitled *Recipient's Personnel Activity Reports Did Not Comply With OMB Circular A-122*.

Note 2: The recipient did not submit fringe benefit rate proposals for fiscal years 2002 through 2004. Accordingly, we questioned reported outlays based on the same rationale discussed in Schedule 1, Note 2.

Note 3: We questioned the reported outlays for contractual costs of \$131,835. Under this cooperative agreement, the recipient awarded a contract to Ecos Consulting valued at \$131,835 without competition, and had no justification to support this lack of competition. Additionally, the recipient did not perform a cost or price analysis for the procurement as required by Title 40 CFR 30.45. We have questioned these contract costs based on the same rationale discussed in Schedule 2, Note 3.

In response to this finding, the recipient indicated that Ecos Consulting possessed a unique set of qualifications that no other consulting firms could provide. According to the recipient, Ecos Consulting was to (1) conduct research on power supply efficiencies and the overall power supply market structure, (2) collect data on power consumption of computer monitors operating in various modes, (3) conduct outreach to key monitor manufactures to discuss the contents of a future performance specification for computer monitors, (4) respond to ceiling fan manufacturers' inquiries regarding the test method for measuring performance of ceiling fans and provide initial thoughts on ways to improve existing performance specification, (5) perform research on the cost effectiveness and energy savings of early retirement programs for refrigerators and room air conditioners, and (6) research the energy efficiency of existing battery chargers used in consumer products. However, the recipient did not provide any documentation to

demonstrate that no other organization was capable of performing the work. An undocumented belief that an organization possesses unique qualifications does not justify making a noncompetitive award. There may be other organizations unknown to the recipient that were qualified and could have performed the work more efficiently and effectively. At a minimum, the recipient should have advertised for request for proposals to verify or confirm that only one source was available to do the work.

Note 4: In the draft report, we questioned the reported outlays because the recipient did not submit its indirect cost rate proposals to EPA for fiscal years 2002 and 2003, and we could not accept the recipient's 2004 proposed provisional rate because of an inadequate labor distribution system. Specifically, the recipient did not require its executive officers to prepare monthly personnel activity reports to support the distribution of their salaries to direct and indirect activities including unallowable direct activities such as lobbying and fundraising. Accordingly, without adequate supporting documentation, we have no way to verify that the executive salaries which were reported as indirect costs were reasonable, allowable, and allocable.

OMB Circular A-122, Attachment B, subparagraph 7.m.(2) requires labor activity reports for employees whose work involves two or more functions or activities if a distribution of their compensation between such functions or activities is needed in the determination of the organization's indirect cost rate(s). Thus, employees, officers included, who distribute their time to other functions such as fund raising, lobbying, membership activities, or other direct functions such as time charges to other affiliated organizations, must maintain labor activity report if the recipient wishes to include the labor costs as part of the indirect cost rate(s).

In response to the draft report, the recipient agreed that it "did not require its executive officers to prepare monthly activity reports to support the distribution of their salaries to all activities, including unallowable activities such as lobbying and fundraising." However, the recipient indicated that executive officers keep track of certain specific activities like lobbying. In addition, on an annual basis, NRDC allocated executive salaries to program, administrative, and fundraising activities.

During our field work, we requested but the recipient did not provide us with any documentation to support (1) the lobbying costs which were excluded from the indirect expense pool, or (2) the allocation of executive salaries, to program, administration, and fundraising activities. Accordingly, without adequate supporting documentation, we have no way to verify that the executive salaries which were included in the indirect costs were reasonable, allowable, and allocable.

In response to the draft report the recipient also provided us with approved indirect rates for fiscal years 2003 and 2004². The rates were approved on August 16, 2005, subsequent to the issuance of the draft report, by the United States Department of Interior, National Business Center (DOI), acting on behalf of EPA. Because of our concerns related to the lack of personnel activity reports as discussed above, we contacted DOI to discuss the negotiation of the final rates. DOI told us that it had no knowledge of our audit or of any of the findings identified in the report. Accordingly, we recommend that the approved rates be rescinded, and DOI consider the findings in this report before negotiating any new rates.

Recommendation 3

We recommend that EPA:

- a. Obtain sufficient documentation to support the questioned outlays of \$356,593 in accordance with EPA regulations or disallow the costs.
- b. Ensure that the recipient submits its fringe benefit cost rates proposals for fiscal years 2002 through 2004 as required by OMB Circular A-122, and not allow any fringe benefits until the rates have been negotiated. In negotiating the rates, we recommend that EPA ensure that the recipient removes the accrued vacation expenses from the fringe benefit pool.
- c. Require the recipient to recalculate and resubmit its fiscal years 2003 and 2004 indirect cost rate proposals for renegotiation. In negotiating the rates, we recommend that EPA ensure that the recipient removes all indirect executive compensation from the indirect expense pool and reallocate the costs to the allocation base. We also recommend that EPA not allow any indirect costs until the rates have been negotiated.

² The recipient still has not submitted an indirect cost rate proposal for fiscal year 2002.

Additional Issue

Recipient's Personnel Activity Reports Did Not Comply With OMB Circular A-122

The recipient's personnel activity reports did not fully comply with the provisions of OMB Circular A-122, Attachment B, subparagraph 7.m. Title 40 CFR 30.27 provides that non-profit organizations shall follow the provisions of OMB Circular A-122 for determining allowable costs. That Circular, Attachment B, subparagraphs 7.m (1) and (2), require that:

...the distribution of salaries and wages to awards must be supported by personnel activity reports....Reports reflecting the distribution of activity of each employee must be maintained for all staff members (professionals and nonprofessionals) whose compensation is charged, in whole or in part, directly to awards....Reports maintained by non-profit organizations to satisfy these requirements must meet the following standards:

(b) Each report must account for the total activity for which employees are compensated and which is required in fulfillment of their obligations to the organization.

The recipient's employees did not record hours worked on their monthly activity reports. Instead, on a monthly basis, the employees estimated the percentage of time that they worked on EPA agreements and lobbying. These monthly activity reports did not account for the total activity for which the employees were compensated. For instance, vacation, holiday, sick leave, indirect activities, and other direct activities such as litigation or other non-Federal projects were not reported on the employees' monthly activity reports.

We did not question any of the labor outlays reported under the agreements because the deficiency in the personnel activity reports did not cause any labor costs to be misallocated to the EPA agreements. The recipient originally accounted for all the labor costs in a non-Federal direct labor account. On a monthly basis, the time devoted to each EPA agreement was reclassified and charged to the EPA agreement(s). Lobbying activities were also estimated monthly and reclassified to a direct lobbying account. Consequently, any time not charged to the EPA agreements or lobbying, remained in the accounting system as a direct labor costs and were not allocated to EPA either directly or indirectly. The recipient agreed with the finding and has implement new time keeping procedures to require employees to account for all work activities for which the employee is compensated. Accordingly, we have no recommendation for this finding.

Scope and Methodology

We performed our examination in accordance with the *Government Auditing Standards*, issued by the Comptroller General of the United States, and the attestation standards established by the American Institute of Certified Public Accountants. We also followed the guidelines and procedures established in the “Office of Inspector General Project Management Handbook,” dated January 14, 2005.

We conducted this examination to express an opinion on the reported outlays, and determine whether the recipient complied with all applicable laws and regulations, as well as any special requirements under the agreement. We conducted our field work from April 14, 2005, through April 29, 2005.

In conducting our examination, we performed the following procedures:

- We interviewed EPA personnel and reviewed grant and project files to obtain background information on the State and the agreement.
- We interviewed recipient personnel to understand the accounting system and the applicable internal controls as they relate to the reported outlays.
- We reviewed the most recent single audit report to identify issues which may impact our examination.
- We reviewed the recipient’s internal controls specifically related to our objectives.
- We performed tests of the internal controls to determine whether they were in place and operating effectively.
- We examined the reported outlays on a test basis to determine whether the outlays were adequately supported and eligible for reimbursement under the terms and conditions of the agreements and Federal regulations and cost principles.

We verified that the recipient performed all tasks and provided all deliverables required under the agreement.

Recipient Response and OIG Comments

August 22, 2005

By Electronic and Overnight Mail

Richard Valliere
EPA-OIG
One Congress Street
Boston, MA 02414-2023

Re: Draft Attestation Report

Dear Mr. Valliere:

The Natural Resources Defense Council, Inc. ("NRDC") provides these comments on the Draft Attestation Report dated July 22, 2005 ("Audit Report"), prepared by the EPA Office of Inspector General ("OIG"). The Audit Report considers reported outlays by NRDC pursuant to EPA Cooperative Agreements CX82546101 ("Grant 1"), CX82675101 ("Grant 2"), and XA83033101 ("Grant 3").

To facilitate our review of and response to the Audit Report, NRDC retained an independent auditing firm, O'Connor & Drew (the "Independent Auditor"). We granted the Independent Auditor full access to NRDC records and employees, and asked it to examine the OIG findings. A description of the firm and its qualifications is appended as Attachment 1. The report the Independent Auditor provided to us is appended as Attachment 2. Some of the comments in this letter are based on the Independent Auditor's advice; others are based on NRDC's own review of its relevant records and practices.

OIG Comment – The recipient's Independent Auditor did not conduct an audit or an examination in accordance with the standards established by the American Institute of Certified Public Accountants. The Independent Auditor was engaged to assist the recipient with responding to the draft report.

Summary of Comments

NRDC has produced all deliverables and performed excellent work under the audited grants. OIG found some good faith deficiencies in our procedures relating to effort reports, indirect costs, and contracting. We have corrected each of these errors. There is no evidence that NRDC drew down federal grant funds for any impermissible purpose.

OIG Comment – We did not have any findings related to work performed or deliverables furnished under the agreements or that the recipient drew down funds for any impermissible purpose.

To the contrary, as the Independent Auditor confirmed: "NRDC's accounting system ensures that only time spent on a federal grant is charged to that grant. The system also precludes any unallowable cost, such as lobbying, from being charged . . . to a federal grant." Attachment 2 at 3.

OIG Comment – The recipient's Independent Auditor also observed that the recipient's "...effort Reporting for Federal Grants and Lobbying timesheets do not account for the total activity for an employee. Examples of the type of activities missing are sick, vacation, personal, unpaid time off, and other time charged to NRDC work."

We do not believe there is a reasoned basis to disallow any labor-related outlays. Our recent back-calculations of fringe benefits and indirect cost rates indicate that some adjustments in amounts we billed for those items may be appropriate. We look forward to discussing directly with EPA those adjustments, which we believe will be in the range of \$70,000 for the eight-year audit period.

OIG Comment – We questioned the labor-related outlays (fringe benefits and indirect costs) under agreements CX82546101 and CX82675101 because at the time of our audit field work, the recipient did not prepare any final indirect costs rate proposals (including indirect fringe benefits) for EPA to negotiate. Without the approved rates, we had no basis to accept the reported outlays.

Similarly, we questioned the labor-related outlays (fringe benefits and indirect costs) under agreements XA83033101 because the recipient did not prepare final indirect costs rate proposals (including indirect fringes benefits) for EPA to negotiate. Subsequent to issuance of the draft report, the United States Department of Interior, National Business Center (DOI) acting on behalf of EPA, negotiated the recipient's final indirect rates³ for fiscal years 2003 and 2004.

Finally, while NRDC entered into sole-source contracts for certain work, we fully disclosed to EPA our intentions and actions, and procured top-level services at below-market cost. Thus, we see no reason to disallow contracting costs.

OIG Comment – Whether or not the recipient fully disclosed its intention and actions to EPA, the recipient was still required to follow the procurement procedures in Title 40 CFR Part 30, and the cost principles in OMB Circular A-122. To be allowable under a grant award, the provisions of OMB Circular A-122, Attachment A, paragraph A.2. provides that costs must (1) conform to any limitation or exclusions set forth in these principles or in the award as to types or

³ The recipient did not submit its indirect fringe benefit rates for negotiation. Therefore, the negotiated rates exclude the recipient's fringe benefits.

amount of cost items, and (2) be adequately documented. The recipient procurement for services did not comply with the grant regulations at Title 40 CFR Part 30. Accordingly, the outlays are not allowable.

Background Facts

EPA awarded Grant 1 to stimulate stormwater education. The grant covered the period December 15, 1996 through October 31, 2001, and totaled \$857,112 in EPA funds. EPA awarded Grants 2 and 3 to encourage the development and marketing of energy efficient products. These grants ran consecutively from September 1, 1998 through December 31, 2005, and committed EPA funds in the amounts of \$1,204,362 (Grant 2) and \$1,198,993 (Grant 3).

EPA has been extremely satisfied with NRDC's work under all three grants. The OIG auditors themselves state: "We verified that the recipient [NRDC] performed all tasks and provided all deliverables required under the agreement[s]." Audit Report at 15.

Indeed, EPA Region 2 presented NRDC with an Environmental Quality Award for our stormwater education work under Grant 1 (for producing and disseminating a report on pollution prevention practices of the 78 municipal governments bordering Long Island Sound). A description of other work we performed under Grant 1, including our reports analyzing and publicizing nationwide data on beach closings and advisories resulting from stormwater and other pollution sources, and our research, analysis, and dissemination of information about successful stormwater management techniques employed across the United States, is described in Attachment 3.

Our energy-efficiency market transformation work (Grants 2 and 3) has been equally effective. Between 1998 and 2004, NRDC's accomplishments under the grants include: conducting groundbreaking research on the energy usage of consumer and office electronics products such as cell phones and computers; leading a national effort to reduce energy use of new refrigerated beverage vending machines by up to 50 percent; creating a rigorous national quality assurance program for efficient lighting, which is directly responsible for the removal of several poor performing models from the marketplace; and establishing an industry-wide labeling and rating system for cool roofing materials, which greatly reduce buildings' air conditioning demands and improve local air quality. A brief summary of achievements related to Grants 2 and 3 is included in Attachment 4, along with a February 2004 Wall Street Journal article describing an innovative, grant-related partnership between Intel and NRDC.

OIG Comment – The recipient's performance and accomplishments under the agreements, and whether EPA's was satisfied with the work performed, has no bearing on the findings in the report. In completing the work under the agreements, the recipient was required to follow all the applicable federal rules and regulations identified in the cooperative agreements. Thus, any failure on

the recipient's part to follow the applicable rules and regulations subjects the recipient to the disallowance of costs.

NRDC Comments on Audit Findings and Recommendations

OIG examined NRDC records to determine whether reported outlays under the three grants in question "fairly present, in all material respects, the allowable costs incurred," and whether NRDC managed the grants "in accordance with applicable requirements." Audit Report at "At a Glance" page. OIG found deficiencies in NRDC records relating to (A) effort reports, (B) indirect costs and fringe benefits, and (C) contracting costs. We address these in order below.

A. Effort Reports

1. OIG Findings

OIG found that employee monthly effort reports used to allocate salary costs to the grants "did not account for the employees' total activities" as required by applicable regulations. Audit Report at 5. OMB Circular A-122 requires that employee activity reports account for all NRDC-compensated activity, not simply activity related to the EPA grants. OIG found that it could not "determine if the labor costs were properly allocated to the EPA grant(s)," and thus questioned reported outlays of \$194,837 (Grant 1), \$375,662 (Grant 2), and \$313,700 (Grant 3), or a total of \$884,199. *Id.* at 6, 7, 11, 13.

2. NRDC Comments

We now understand that 40 C.F.R. § 30.27 and OMB Circular A-122 require NRDC employees charging time to a federal grant to record time for all work for which NRDC compensates them. Before the OIG examination of our records, we were not aware of this requirement, and required employees working on the grants to record only the percentage of total work time they spent on grant-related matters. This was an error on our part.

We have fully corrected the error. As of February 2005, we have required all NRDC employees working on any federal grant to record monthly *all* work activities for which NRDC compensates them. See Attachment 5 (revised NRDC effort report form). At our request, the Independent Auditor reviewed our new timesheets and verified their compliance with applicable federal regulations. Attachment 2 at 3. We are implementing the few suggestions the Independent Auditor made for further improvements in these records. *Id.*

OIG Comment – It appears that the new procedures, if corrected to include lobbying time, as recommended by the recipient's Independent Auditor, will comply with the procedures in OMB Circular A-122. However, to clarify a point, we would like to mention that OMB Circular A-122, Attachment B, subparagraph

7.m.(2) also requires labor activity reports for employees whose work involves two or more functions or activities if a distribution of their compensation between such functions or activities is needed in the determination of the organization's indirect cost rate(s). Thus, indirect employees, officers included, who distribute their time to other functions such as fund raising, lobbying, membership activities, or other direct functions such as time charges to other affiliated organizations, must maintain labor activity report. Otherwise the labor costs will have to be treated as unallowable direct costs.

While we are grateful to OIG for illuminating a limitation in our recordkeeping, we find it difficult to understand its questioning of more than \$880,000 in reported outlays for grant-related labor. NRDC based salary charges to the EPA grants on after-the-fact determinations of the actual activities of each employee, expressed as a percentage of the employee's whole NRDC work effort each month. This is, in effect, what OMB Circular A-122 requires. There is no evidence, either cited in the Audit Report or of which we are aware, that NRDC's actual allocation of human effort to any of the three grants was in any way inaccurate or problematic. To the contrary, the work NRDC produced under each of the grants clearly required the degree of effort our employees expended and reported.

Additional factors undermine OIG's questioning of the reported outlays. On Grants 2 and 3, NRDC's principal program person spent 93 percent or more of his work time on grant-related matters. As a result, the timesheet deficiency barely applies to him, because there was virtually no non-grant-related effort for him to report. For the two grants combined, this accounts for \$451,659 in salary outlays, or nearly two-thirds the salary outlays (\$689,362) OIG questioned under these grants. See Attachment 6.

NRDC's limited recordkeeping was a good faith error. During each year of the grants in question, NRDC effort reports were reviewed in an A-133 audit by a reputable independent auditor, PricewaterhouseCoopers. Although this annual review was geared specifically to the accuracy, completeness, and compliance of our accounting under government contracts, our auditor did not find the error.

Neither did EPA itself. On March 10, 1999, an EPA grant specialist visited NRDC's San Francisco Office (out of which the market transformation grants are run). The purpose of the site visit was to monitor and review the "administrative and financial aspects of" the EPA grants. See Attachment 7 (May 3, 1999 EPA letter commenting on site visit). After completing their review, the EPA site monitors found that NRDC "appears [to be] complying with the terms and conditions of the awards." *Id.* To the degree there was any subsequent EPA Desk Review of NRDC's practices and procedures, the agency never informed us of any recordkeeping (or other) deficiency. We presume EPA conducted its review according to the agency's elaborate "On-Site Monitoring and Evaluation Instrument," Attachment 8, a copy of which it provided to us in advance of the March 1999 site visit. The purpose of the Instrument is to assist EPA in "effective monitoring of" grant recipients so as to "avoid or reduce negative audit findings, waste or abuse of federal funds." *Id.* at 1.

NRDC requires all employees to document lobbying activities and vacation and sick days. The lobbying records provide the date, hours, subject matter, and expenses associated with lobbying, and are given a separate and specific code. This procedure provides confidence that no NRDC employee charged lobbying or any other unallowable time against a government grant. With regard to this possibility, suggested by OIG, the Independent Auditor found:

The effort reports used by NRDC meet the criteria contained in OMB Circular A-122 with the exception of accounting for 100 percent of an employee's activity. However, *NRDC's accounting system ensures that only time spent on a federal grant is charged to that grant. The system also precludes any unallowable cost, such as lobbying, from being charged, directly or indirectly, to a federal grant.*

Attachment 2 at 3 (emphasis supplied).

In sum: We acknowledge a deficiency in our effort reports; we have corrected the inadvertent error; despite the error, NRDC had controls in place ensuring that only allowable activity was charged to EPA grants; and we believe there is no reason to disallow any of the questioned labor-related outlays.

OIG Comment – The recipient's personnel activity reports did not fully comply with the provisions of OMB Circular A-122, Attachment B, subparagraph 7.m (see page 15 for further details). However, we have reevaluated our position related to questioning the labor outlays because of this noncompliance and have reinstated the questioned outlays.

B. Indirect Costs

1. OIG Findings

OIG found that NRDC (a) failed to compute fringe benefits as an indirect cost, Audit Report at 8; (b) may have recovered vacation costs twice (through both salaries and fringe benefit rates), *id.*; (c) did not prepare or submit indirect cost rate proposals to EPA, *id.* at 5; and (d) did not require executive officers to prepare monthly activity reports to support the distribution of their salaries to all activities, including lobbying and fundraising, *id.* at 13. For these reasons, for the three grants combined, OIG questioned \$190,941 in fringe benefit costs, and an additional \$539,618 in indirect costs. *Id.* at 6, 11, 13.

2. NRDC Comments

a. Fringe Benefits

NRDC considered fringe benefits to be direct, not indirect, costs. This appears to be proper under the governing regulations. The Independent Auditor notes that the citation on which OIG relies for its finding does not refer to fringe benefit rates, but only to indirect cost rates. OMB Circular A-122, Attachment B, section 7(g)(2), provides that fringe benefits can be treated either as direct or indirect costs. See Attachment 2 at 4. The Independent Auditor further found that NRDC's method of developing fringe benefit rates annually and applying such rates to the salaries of grant-related personnel is "common among federal grant and cooperative agreement recipients." *Id.*

NRDC has now developed actual (rather than estimated) fringe benefit rates for each fiscal year from 1997 through 2004. In some years the rate billed to the government exceeded the actual rate; in other years the rate billed was less than the actual. See Attachment 9 (NRDC calculations); see *also* Attachment 2 at 4. We will discuss these calculations with EPA, and make any appropriate adjustment. We believe that any such adjustment will be within the range of \$10,000 over the eight-year period.

OIG Comment - The recipient is correct that OMB Circular A-122, Attachment B, section 7(g)(2), provides that fringe benefits may be treated as either a direct or indirect costs. The recipient has chosen to treat certain fringe benefits such as accrued vacation, health insurance, pension, and life insurance as indirect costs. Consequently, the recipient was required to submit new indirect cost rate proposals to the cognizant agency within 6 months after the close of each fiscal year in accordance with OMB Circular A-122. We can not accept the reported outlays for indirect fringe benefit costs until the recipient submits, and EPA negotiates, final rates for all fiscal years reported under the agreements. Therefore, we recommend that the recipient submit its fringe benefit rates to EPA for negotiation as required by the Circular.

b. Vacation Costs

Regarding vacation time, the Independent Auditor determined that NRDC did not over-recover costs. Attachment 2 at 4.

OIG Comment - The recipient's Independent Auditor indicated (see Attachment 2 at 5) that the recipient informed them that it will eliminate accrued vacation expenses in calculating actual fringe benefit rates. The elimination of the accrued vacation time from the actual rates will remedy the potential over-recover of costs.

c. Indirect Cost Rates

NRDC submitted to EPA an initial indirect cost rate proposal in July 1995. Attachment 10. In April 1996, EPA distributed a policy statement relating to indirect cost rates. Attachment 11. The policy provided that grant recipients were *not* required to submit a proposal to EPA if indirect costs were "35% or less of total project costs and represent less than \$200,000." *Id.* at 3.

Grants 1 and 3 fit within this category. In the Audit Report, OIG states that the EPA policy was rescinded, but does not state when. Audit Report at 9. In reliance on the policy, NRDC did not submit additional indirect cost rate proposals to EPA.

NRDC did, however, diligently seek further guidance from the agency. We wrote to EPA on September 8, 1997, seeking confirmation that no further cost rate proposal was required. Attachment 12. We called EPA on September 16, 1997, for the same purpose. Attachment 13 (handwritten notes summarizing call). We called EPA again on January 13, 1998, and followed up with a letter dated January 14, 1998. Attachment 14.

On March 10, 1999, EPA conducted its site visit to our San Francisco office, and, as noted above, found no deficiencies in our administrative or financial practices or procedures, including the calculation of indirect costs. Attachment 7.

On July 15, 1999, by telephone, an EPA grant specialist advised us that the 22.29% indirect cost rate we had proposed in 1995 still applied. Attachment 15 (notes summarizing call). EPA's notices of award for Grant 3, first issued in 2002, included an indirect cost rate of 22.29%. Attachment 16.

On August 4, 2004, we prepared an indirect cost rate proposal based on fiscal year 2003 costs, and submitted it to EPA as part of the application package for renewal of the market transformation grant. On March 15 of this year, NRDC submitted the same proposal, presented in the format specified by EPA. Attachment 17. EPA is now considering our proposed indirect cost rates for 2003 and 2004.

We do not believe the failure to submit annual indirect cost rate proposals to EPA should cause OIG to question, or EPA to disallow, any indirect costs under the grants. As the Independent Auditor found: "NRDC followed the guidance provided by EPA officials . . . and followed the rules that were in effect at the time." Attachment 2 at 10. And we repeatedly sought confirmation that we were, in fact, in compliance.

We recognize and concede a good faith error regarding indirect costs: We should have updated our indirect cost rates each year internally, kept them in our files, and adjusted our billings to EPA accordingly. In addition, we should have submitted to EPA a proposed cost rate each year during the pendency of Grant 2. We have now performed the requisite calculations. Attachment 18. The rates indicate that NRDC may have over-recovered indirect costs of approximately \$50,000 for the eight-year period covered by the OIG audit. We will pursue this matter directly with EPA, and

make any appropriate adjustment. But for this amount, we see no basis for disallowing any indirect cost charged to the grants.

OIG Comment – EPA's policy to allow the recipient to retain the indirect cost rate proposal(s) on file did not comply OMB Circular A-122, Attachment A, subparagraph E. 2. EPA cannot deviate from the requirements of the Circular unless a waiver is granted by OMB. EPA rescinded its policy after we informed EPA that the policy did not comply with the Circular.

The recipient indicated that it prepared and submitted an initial indirect cost rate proposal to EPA in July 1995. After the recipient establishes an initial indirect cost rate, the Circular required the recipient to submit new indirect cost proposals to the cognizant agency within six months after the close of each fiscal year. The recipient did not prepare, or at least did not provide us with, any final indirect cost rate proposals for FYs 1996 through 2002. Accordingly, we have no basis to accept any of the indirect costs for this period.

As part of the response to this report, the recipient did provide us with the approved indirect rates for FYs 2003 and 2004. The rates were approved on August 16, 2005, subsequent to the issuance of the draft report, by the United States Department of Interior, National Business Center (DOI), acting on behalf of EPA. Because of our concerns related to labor documentation problems identified in this report, we contacted DOI to discuss the negotiation of the final rates. DOI told us that it had no knowledge of our audit or of any of the findings identified in the report. Accordingly, we recommend that the approved rates be rescinded, and DOI consider the findings in this report before negotiating any new rates.

We cannot accept the reported outlays for any of the indirect costs until the recipient resubmits its indirect cost rate proposals and excludes all executive salaries from the indirect expense pool and add the salaries to the allocation base (see our discussion below on executive salaries).

d. Allocation of Executive Salaries

OIG notes correctly that NRDC "did not require its executive officers to prepare monthly activity reports to support the distribution of their salaries to all activities, including unallowable activities such as lobbying and fundraising." Audit Report at 13. However, OIG's further statement that "controls were not sufficient to ensure that labor was allocated equitably, and unallowable activity, such as lobbying, was excluded from EPA grants," *id.*, is, in our view, both unsupported and incorrect.

NRDC's executive officers keep track of certain specific activities like lobbying. In addition, on an annual basis, NRDC allocates executive salaries to program, administrative, and fundraising activities. The Independent Auditor found that "NRDC's accounting system precludes any unallowable costs from being charged to a Federal

grant. All lobbying and fundraising costs, including the portion of executive salaries, are removed from the indirect cost pool." Attachment 2 at 10. Thus, any unallowable effort by NRDC executives is excluded from the indirect cost calculation. In addition, we note that the amount of executive salary charged through indirect costs is minimal (calculated by the Independent Auditor as 0.3%, see *id.*). No NRDC executive charges any direct time to any of the federal grants.

Accordingly, we see no reasoned basis to question whether unallowable executive activity, such as lobbying or fundraising, was charged to any of the audited grants. Notwithstanding this, in order to simplify accounting going forward, NRDC will eliminate from its indirect cost rate calculation all salary for any executive allocating time to more than one activity.

OIG Comment – By the recipient’s own admission, the executives did not prepare monthly activity reports to support the distribution of executive salaries to the indirect cost pool or direct cost activities such as lobbying, fundraising, membership activities, or program administration. The provisions of OMB Circular A-122, Attachment B, subparagraph 7.m(2) requires labor activity reports for employees whose work involves two or more functions or activities if a distribution of their compensation between such functions or activities is needed in the determination of the organization’s indirect cost rate(s). Without adequate supporting documentation, we have no way to verify that the executive salaries which were included as indirect costs were reasonable, allowable, and allocable. Accordingly, we recommend that all executive salaries be excluded from the indirect cost pool for all fiscal years and added to the indirect cost allocation base.

C. Contracting Costs

1. OIG Findings

OIG questioned outlays of \$291,016 attributable to nonsalaried employees, Audit Report at 8, based on the failure to keep full time records (see section A above). In addition, OIG questioned outlays of \$473,995 (Grant 2) and \$131,835 (Grant 3) because NRDC "procured sole-source consulting services without justification or performing a cost or pricing review." *Id.* at 5, 11, 13.

2. NRDC Comments

a. Nonsalaried Personnel

Some people who performed grant-related work were short-term or part-time personnel. NRDC charged their time as consultants, because NRDC itself did not treat them as full-time employees (with full benefits). Since these people only received NRDC pay for the hours they worked on the grant, their timesheets reflect all their

NRDC-compensable activity. According to the Independent Auditor, these timesheets meet all applicable federal criteria. Attachment 2 at 6.

OIG Comment – The recipient’s personnel activity reports did not fully comply with the provisions of OMB Circular A-122, Attachment B, subparagraph 7.m. See page 15 for our report related to the improvements needed in the personnel activity reports. However, we have reevaluated our position related to questioning the labor outlays because of this technical noncompliance and have reinstated the questioned outlays.

OIG also questioned fringe benefits related to nonsalaried labor, in the amount of \$28,697. Audit Report at 8. NRDC is in the process of recalculating these fringe benefit figures, as we have done for salaried employees, to account for any difference between estimated and actual expenses. We will present our calculations to EPA, and make any appropriate adjustment.

OIG Comment – See our first comment on page 23 related to fringe benefits.

Finally in this regard, OIG questioned \$74,008 because NRDC did not provide labor activity reports to support the outlays. Audit Report at 9. These are costs associated with a number of nonsalaried employees and vendors, and involve small increments of time. We have gathered available documentation supporting these charges, and believe the questioned outlays are appropriate. Attachment 19.

OIG Comment – Although the recipient states it has gathered documentation supporting the questioned outlays, it did not provided any of the documentation for review. Accordingly, the outlays remain questioned.

b. Sole-Source Contractor

The major financial item in the contractor category relates to the work of Ecos Consulting on the market transformation grants. In performing its appointed tasks under Grant 2, NRDC awarded three contracts to Ecos, valued at \$473,995, without competitive bidding. Audit Report at 11. Under Grant 3, NRDC awarded a noncompetitive contract to Ecos worth \$131,835. *Id.* at 13.

While the contracts with Ecos were not subject to competitive bidding, OIG fails to recognize, or give sufficient weight to, various pertinent facts. Ecos had been a sole-source consultant since the inception of the market transformation grants. EPA program staff were fully aware of NRDC's actions with regard to Ecos, because both the intent to retain Ecos and specific budget lines to cover its work were set forth explicitly in NRDC's grant proposals. Attachment 20.

Despite EPA's knowledge of NRDC's intentions and actions, the agency did not notify NRDC of the need for competitive bidding until 2002. Since that time, NRDC has bid out contract work competitively. The process includes developing a qualified

bidders list, preparing a written request for proposals ("RFP"), sending the RFP to the bidders list, reviewing written bids, scoring bids, identifying the winning bidder, and negotiating and executing a contract with the victorious firm.

We are aware of no evidence that Ecos overcharged in any way for its services. Indeed, Ecos substantially outscored and provided a more cost competitive proposal than its competitor during the 2003 process we instituted. See Attachment 2 at 7; see *also* Attachment 21. Our experts in energy-efficiency market transformation, who have earned the trust of EPA program staff, were fully aware of the available expertise and going prices in the relevant market from 1998-2003, and believe that Ecos performed excellent work at reasonable rates throughout the period of the audited grants. As of late 2001, for example, billing rates in excess of \$100 or \$150 (for senior personnel) per hour were common in the industry, but NRDC paid far less for Ecos's first-rate services. NRDC (and federal taxpayers) benefitted from Ecos's two-tier pricing structure, which provided reduced rates for nonprofit groups like NRDC. See Attachment 21.

The record reveals that NRDC adequately documented its reasons for selecting Ecos. Indeed, NRDC's *written grant proposals to EPA* contained sufficient justification for NRDC's decision. Given this, and the fact that Ecos performed high-quality, economical work under the grants, we see no reason to disallow any of the questioned outlays.

OIG's Comment - While EPA may have been aware of the recipient's action to procure a specific consulting firm, it did not relieve the recipient of its responsibility to adequately justify the lack of a non-competitive procurement or perform the required cost analysis. The recipient has not provided adequate documentation to justify the sole source procurements or documentation to support that a cost analysis was conducted. Accordingly, the outlays remain questioned.

Concluding Comments

We found the OIG audit to be useful in highlighting a few deficiencies in our grant-related recordkeeping. However, but for the updated fringe benefit and indirect cost rate calculations discussed above, we respectfully object to any suggestion in the Audit Report that EPA disallow questioned outlays. Based on the Audit Report, the Independent Auditor's examination, and our own further review of our records and procedures, we do not see any basis in the evidence or in common sense to do so.

Where, as here, there are good faith errors in recordkeeping, all corrected, no evidence of harm or wrongdoing, and ample affirmative evidence supporting the legitimacy, economy, and quality of a recipient's effort under federal grants, we believe it would be arbitrary, punitive, and unjust to disallow costs.

We look forward to resolving all outstanding issues with EPA. If we can provide any further information, or if OIG would like to meet with us to explore further any relevant issue, please let us know.

In whatever form and to whomever OIG disseminates its final report, including without limitation on the EPA Web site, we request that you include, *in toto*, this response letter, with all attachments.

Thank you for the opportunity to comment.

Sincerely,

/s/ Judith A. Keefer

Judith A. Keefer
Director of Finance and Operations

Attachments

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